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An Equitable Path to Retirement Security: Retirement Savings Vehicles and Social Security

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This explainer explores legislation intended to strengthen retirement security in Congress, in particular the Securing a Strong Retirement Act of 2021. While the bill would provide greater access to pre-tax retirement savings options for working people, it would not provide retirement security to as broad a swath of people as proposals that strengthen and expand Social Security. For the reasons explained below, though the former approach is meaningful for some, mainly higher-income Americans, the latter approach will help families across the income spectrum. The author thanks the Center for Economic and Policy Research, Economic Policy Institute, and Social Security Works for their valuable feedback.

The Securing a Strong Retirement Act of 2021: Increased Access to Retirement Savings

The Securing a Strong Retirement Act of 2021, H.R. 2954, was introduced to help working people increase their retirement savings by providing greater access to pre-tax retirement options such as 401(k)s and IRAs. H.R. 2954, or the SECURE Act 2.0, builds upon and tweaks aspects of the Setting Every Community Up for Retirement Enhancement Act (or SECURE Act), H.R. 1994 which went into effect on January 1, 2020.

H.R. 2954, sponsored by Ways and Means Committee Chairman Richard Neal (MA-01) and ranking member Kevin Brady (TX-08) would automatically enroll workers in their companies' 401(k) plans when a new plan is opened, allow part-time workers to participate in 401(k) plans for the first time, and raise the maximum age to begin mandatory distributions from age 70½ (age 72 if 70th birthday was July 1, 2019 or later) to age 75. People aged 75 and over would be exempted from taking mandatory minimum disbursements from their plans if they make less than $100,000 each year. The bill also increases "catch-up" contributions that individuals over 50 can make to their 401(k) or IRA, allowing an extra $6500 for 401(k) plans and $1000 annually for IRAs.

H.R. 2954 would also let workers get 401(k) matching contributions from their employer for student-loan debt repayment instead of retirement savings account contributions. As well, the bill would instruct the IRS to simplify the SAVERS credit, which gives additional tax breaks for lower-income workers and indexes the credit to inflation.

Additionally, the bill expands retirement savings options for people who work for nonprofits by allowing groups of nonprofits to join together to offer retirement plans. H.R. 2954 also makes it easier for military spouses to save for retirement by incorporating the Military Spouses Retirement Security Act. The bill also creates an online national database of retirement accounts, making it easier for working people to regain access to the retirement accounts they may have lost as they moved from employer to employer or those with state-based plans who may have moved to another state.

Critiques of the Securing a Strong Retirement Act of 2021

While much of H.R. 2954 is laudable, there are some issues worth consideration. Automatic enrollment does help increase the number of people who use retirement savings vehicles. As explained below, though, these vehicles are often expensive for lower-income workers. Families that may not be able to afford to participate in these programs could be locked into these plans, and experience a loss of much-needed available funds. Many of these plans often have high fees, meaning that stock brokers and plan advisors who are not registered fiduciary agents have the most to gain from automated enrollment. In worst-case scenarios, some families may be forced to rely on payday lenders to pay for necessities, until they navigate the process of opting out of automated retirement contributions, forcing them into a downward spiral of debt.

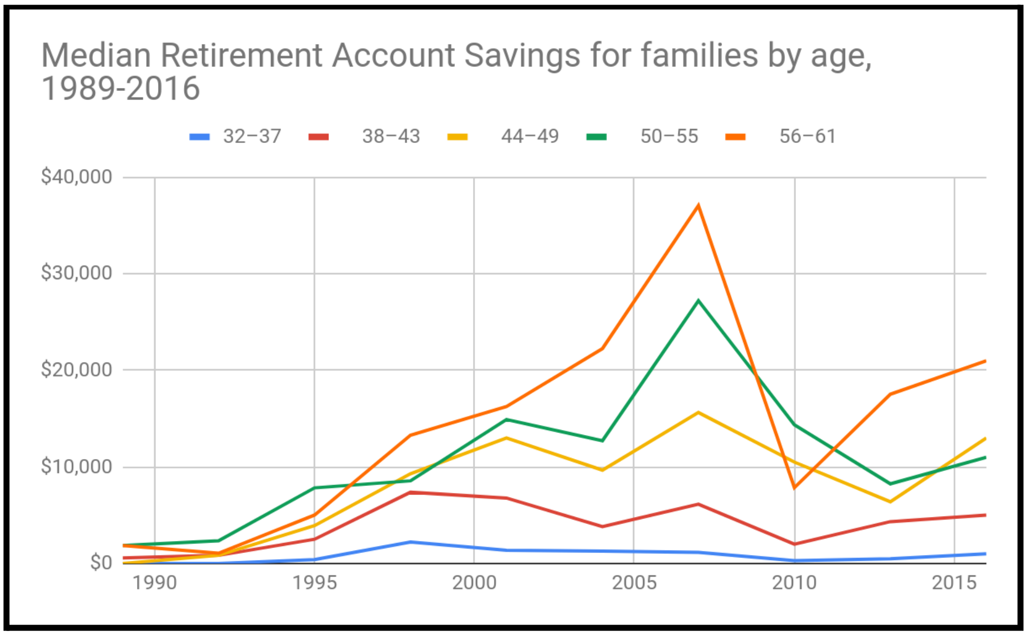
The provision to provide an employer match for student loan payments is opt-in, so it is likely that only high-road employers which employ pro-worker best practices will offer this perk. It is not clear why opt-in would be used for retirement savings but not for student loan payments.

The tweaks to the SAVERS credit could be helpful to many families, but the credit does not appear to be fully refundable and would not help those who would need it most. Moreover, as explained below, there are clear risks associated with pinning retirement income to the stock market for moderate- and lower- income individuals.

Finally, while it makes sense to exempt from the mandatory minimum distributions those with incomes under $100,000, raising the age of those mandatory distributions to age 75 appears to be primarily a tax giveaway, allowing the very wealthiest to save and invest their incomes tax-free for estate planning rather than retirement purposes. Given that the federal estate tax affects so few estates, this provision appears bound to increase income and generational wealth inequality.

Pre-tax Retirement Plans: Risk and Regressivity

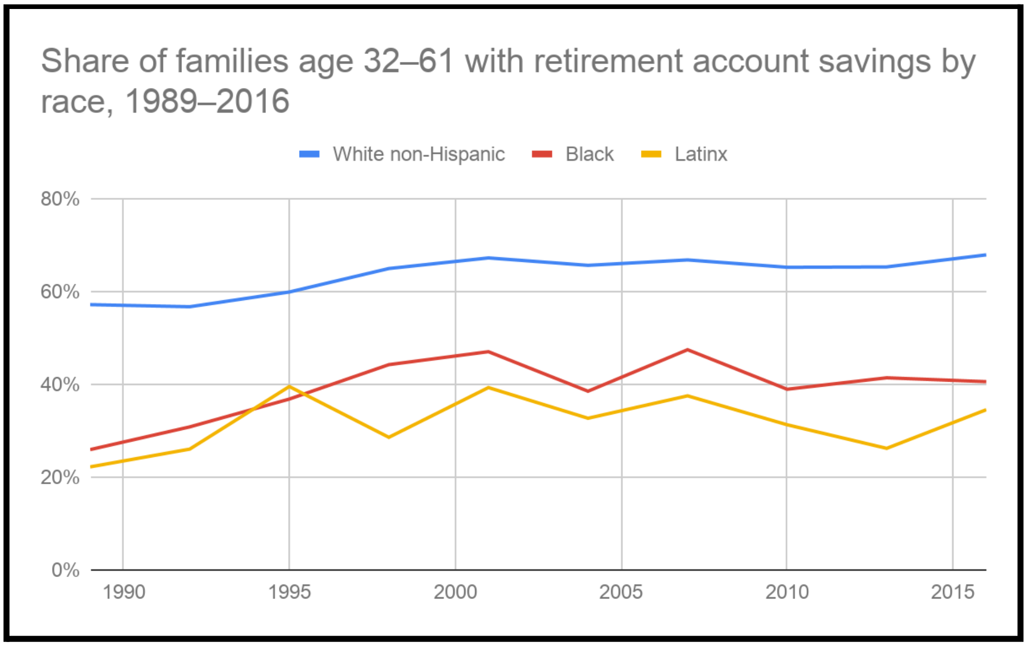
While 401(k)s and IRAs can be good vehicles for saving, retirement vehicles that are tied to the stock market carry inherent risks. Each time there is a fluctuation in the market, retirement assets are directly affected. In the aftermath of a recession, near-retirees could see their retirement savings take a significant hit. And while the stock market was resilient in the K-shaped recovery from the COVID-19 recession, this is not typical. In the wake of the Great Recession, for instance, through 2016, no age group had fully recovered the losses to their plans since the 2007 peak just before the recession. The very wealthiest may have other assets to be able to draw upon to weather the downturns, but lower-income retirees and near-retirees generally have no choice but to draw down savings. Consequently, this approach seems destined to increase income and wealth inequality.



Author's analysis of Federal Reserve's Survey of Consumer FInances

As a policy tool, pre-tax retirement plans fail to provide a secure retirement for the widest swath of people as possible and do little to address inequality. Lower-income earners often cannot afford to participate in pre-tax retirement plans. When they do, their contributions are generally much smaller in absolute amounts and as a share of their incomes. As a result, higher-income earners make up the majority of plan participants and reap the majority of the benefits as well. One estimate suggests that 85 percent of IRA benefits accrue to the top 40 percent of US households.

Not only are retirement savings accounts distributionally regressive, they are also racially inequitable. The majority of black and Latinx households have no retirement account savings at all. Among those households that do have retirement savings, the median household retirement savings were $29,200 for Black households and $23,000 for Latinx households, compared to $79,500 for white non-Hispanic households. (The Federal Reserve did not survey Asian American-Pacific Islander or Native American households.)



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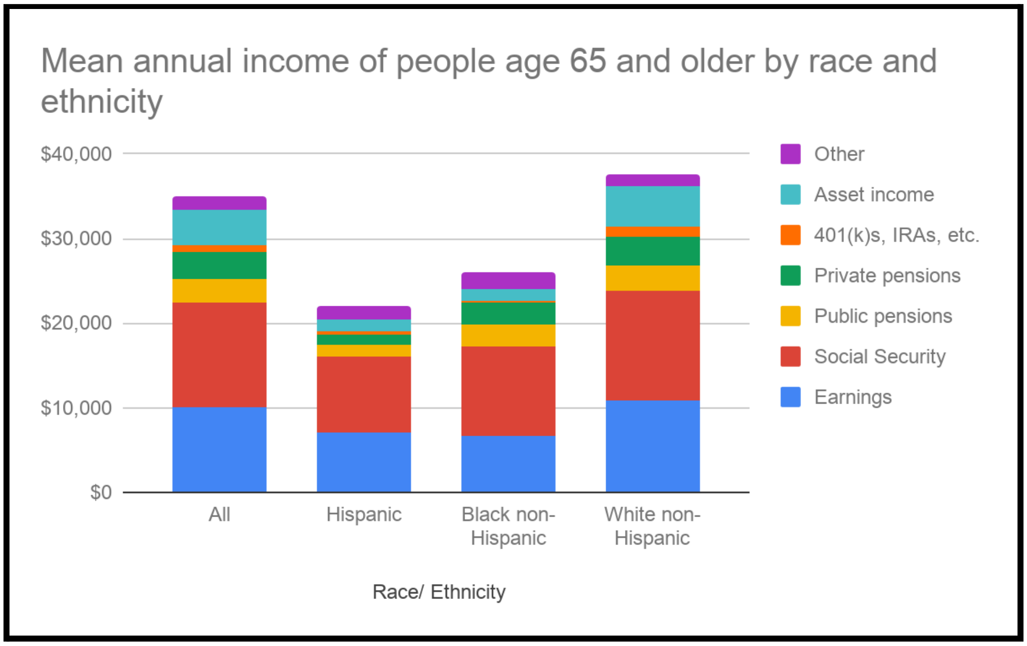
Enrolling lower-income workers automatically in tax-favored retirement savings vehicles assumes that those individuals are not making rational choices when they choose not to enroll in these arrangements. Given limited resources, high brokerage fees, high fees for early withdrawals, and the risk of bear markets, the decision not to opt in may be completely rational. If that is true, forcing an opt-out could have more downsides than upsides.

The most reliable means to produce adequate retirement income is a plan that replaces wages in the event of retirement, where longevity and other risks are pooled. This is what Social Security provides and what employer-sponsored defined benefit pension plans provide. But the number of people covered by employer-sponsored defined benefit plans has fallen considerably, falling from 48 percent of working people in 1970 to only 12 percent of private-sector workers as of 2019. And as detailed here, pre-tax retirement savings plans are simply not an option for many working people. In contrast, Social Security has stood the test of time.

Retirement insecurity could be reduced overnight, without new startup costs, simply by increasing Social Security's modest benefits.

Social Security As A Share of Retirement Income

Social Security benefits are the most important source of retirement income for retirees. For over half of people 65 and older, Social Security makes up [50 percent] or more of their total retirement income. And for about 1-in-4 people over age 65, Social Security makes up [90 percent] or more of their retirement income.



Federal Reserve's Survey of Consumer FInances

It is important to recognize that unlike H.R. 2954, increasing Social Security retirement benefits automatically increases disability and survivor benefits, because they are derived from the same formula.

Progressive Efforts To Shore Up Retirement Security

In his campaign, President Biden proposed expanding Social Security, as did the 2020 Democratic platform. Similarly, during the 116th session of Congress, there were a number of bills that sought to increase Social Security benefits, while restoring the program to long-term actuarial balance. A number of those bills have been reintroduced or their sponsors plan to re-introduce them in the current Congress.

The Social Security 2100 Act, H.R. 860, sponsored by Rep. John Larson (CT-01), with 209 cosponsors; the Social Security Expansion Act, H.R. 1170, sponsored by Rep. Peter Defazio (OR-04); the Protecting Our Widows and Widowers in Retirement (POWR) Act, H.R. 1540, sponsored by Linda Sanchez (CA-38); the Fair COLA for Seniors Act, H.R. 1553, sponsored by Rep. Garamendi (CA-03); the Protecting and Preserving Social

Security Act, H.R. 2302, sponsored by Rep. Ted Deutch (FL-22); the Strengthening Social Security Act, H.R. 2654, co-sponsored by Rep. Linda Sanchez (CA-38) and Rep. Mark Pocan (WI-02); the Social Security Fairness Act, H.R. 141, sponsored by Rep. Rodney Davis (IL-13), with 264 cosponsors; the Public Servants Protection and Fairness Act, H.R. 4540, sponsored by Rep. Richard E. Neal (MA-01), with 154 cosponsors; and other proposals would strengthen Social Security in a number of ways.

The Defazio, Deutch, Garamendi, Sanchez-Pocan, and Larson bills called for a switch to the Consumer Price Index for the Elderly (CPI-E) rather than the currently used Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W) for better and more accurate Social Security cost of living adjustment calculation. The DeFazio and Larson bills also provided an increase in the minimum Social Security benefit to 125 percent. Those bills and the Sanchez-Pocan bill provided across the board benefits, though progressively structured. The Sanchez bill increases the current survivor benefit for two-earner couples where earnings were similar. The DeFazio, Deutch, Sanchez-Pocan, and Larson bills would have increased the amount of income subject to the Social Security FICA payroll tax to extend solvency. The Davis bill eliminates the government pension offset which currently reduces survivor benefits for spouses, widows, and widowers with pensions; and reverses the windfall elimination provision which can reduce Social Security benefits for beneficiaries who have a pension or disability benefit but whose employers did not withhold Social Security taxes. The Neal bill reforms the windfall elimination provision.

Social Security has the advantages of both private-sector defined-benefit and defined-contribution plans. It is excellent for mobile workers, because it is portable from job to job, and excellent for long-term workers because it is structured, as private sector defined benefit plans are, to replace final pay through the way wages are indexed. While 401(K)s, IRAs, and other pre-tax vehicles encourage saving and can help workers build a nest egg, they do little to address inequality and are inherently regressive. In contrast, boosting Social Security benefits clearly helps those who are most vulnerable to live more comfortably in their retirement years. If the highest-income earners are required to pay more, as all of the expansion bills do, it helps to address pervasive income and wealth inequality.

Social Security is the primary source of income in retirement for most Americans, so expanding the program is an excellent path to greater retirement security for everyone. Congress has recently dealt with private pensions through the SECURE Act and the multiemployer provisions in the recent reconciliation bill, but has not yet held even a Committee vote on any Social Security expansion legislation. Regardless of the fate of bills like H.R. 2954, Congress should address Social Security in this Congress. It should hold hearings, mark up, report out, and vote as a body on a package that at least represents the reforms proposed by President Biden, when he was a candidate, as well as other expansions. Such a move would be both wise policy and winning politics.